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In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 5

PEOPLE OF THE STATE OF CALIFORNIA,
Appellants,

vs.

EL PASO NATURAL GAS COMPANY, et al,
Appellees.

Brief of the People of the State of California

I.

OPINIONS BELOW

On June 24, 1965, the District Court entered its Decree for Divestiture in *United States of America v. El Paso Natural Gas Company*, et al, Civil No. 143-57 (R. 2172). Prior thereto on July 22, 1964, California had filed timely Application for Leave to Intervene in the divestiture proceedings in the District Court (R. 53). By Order dated January 22, 1965, such Application made pursuant to Rule 24(A)(2) and (A)(3) and Rule 24(B)(2) of the Federal Rules of Procedure was denied by the lower court (R. 1131).

California, on March 15, 1965, filed a Notice of Appeal from the Order Denying Intervention (R. 1524). In addition to an appeal from the denial of intervention, on July 16, 1965, California filed a Notice of Appeal from the Decree for Divestiture (R. 2196).

The opinion of the lower court is not reported in the official reports of the Federal Reporter.

On January 17, 1966, the Supreme Court made its Order Noting Probable Jurisdiction (R. 2207).

II.

JURISDICTION

California's efforts to intervene were made pursuant to the Federal Rules of Civil Procedure. California in its Application for Intervention (July 22, 1964) pointed out its unique dependence upon the El Paso Natural Gas Company (El Paso) for imported gas. California recited its unique position as a sovereign state vitally affected by the divestiture proceedings and importantly, in addition to its request based upon the rules pertaining to intervention, pointed out that it was imperative that the District Court order divestiture "without delay" as had previously been directed by the Supreme Court of the United States in *United States of America v. El Paso Natural Gas Company*, 376 U. S. 651, (April 6, 1964). California sought review then on two grounds; (1) that it was entitled by right to intervene to protect its special situation with reference to the impact of divestiture upon its gas consumers and (2) California sought review and intervention because it was then and is now of the opinion that the mandate of this Court previously referred to is not being met—in fact it is being disregarded.

The jurisdiction of the Supreme Court is conferred by the Expediting Act, Title 15 U.S.C.A., Section 29, 32 Stat. 823 (1903 as amended), 36 Stat. 1167 (1911), 58 Stat. 272 (1944), 62 Stat. 989 (1948).

Jurisdiction is clearly supported by these authorities: *Sam Fox Publishing Co. v. United States*, 366 U. S. 683 (1961); *Allen Co. v. Cash Register Co.*, 322 U. S. 137 (1944); *United States v. California Cooperative Canneries*, 279 U. S. 553 (1929); *Missouri-Kansas Pipeline Co. v. United States*, 198 F. 2d 614 (3rd Cir. 1939), cert. den. 309 U. S. 683 (1939). (See Jurisdictional Statement of California, Page 6.)

Jurisdiction is inherent because this court possesses power to review its own mandate:

United States of America v. El Paso Natural Gas Company, 376 U. S. 651 (1964),

United State of America v. DuPont De Nemours & Co., 366 U. S. 316, 325,

Continental Insurance Co. v. United States, 259 U. S. 156, 166.

III.

QUESTIONS PRESENTED

1. Whether the specific mandate of the Supreme Court of the United States as enunciated in *United States of America v. El Paso Natural Gas Company*, 376 U. S. 651, wherein the court stated: "We not only reverse the judgment below but direct the district court to order divestiture without delay." is being obeyed.

2. Whether the District Court erred in denying California's Application to Intervene pursuant to Rule 24(A)(2), Rule 24(A)(3) and Rule 24(B) of the Federal Rules of Civil Procedure.

3. Whether the Decree for Divestiture which is here challenged disables the successor to Pacific Northwest Pipe-

line Corporation from effective competition for the California gas market.

IV.

STATEMENT OF THE CASE

The Long History of Litigation

This litigation is understood only by reference to the vintage which has attached to it. It was on June 18, 1954, that Pacific Northwest Pipeline Corporation received certificate approval from the Federal Power Commission. It was on November 8, 1956, that shareholders of Pacific and El Paso agreed upon the terms of a stock exchange offer. It was on June 22, 1957, that the United States Attorney General charged that the purchase of Pacific stock by El Paso lessened competition and tended to create a monopoly. (*United States v. El Paso Natural Gas Company and Pacific Northwest Pipeline Corporation*, Civil Action No. 143-57, U.S.D.C. for Utah Central Division). Thereafter proceedings were held before the Federal Power Commission and on December 23, 1959, that agency approved the merger of the two pipeline corporations. In *California v. Federal Power Commission*, 369 U. S. 482 (1962), this court held that the agency exceeded its jurisdiction in approving an asset acquisition by El Paso of Pacific at a time when such transaction was charged to be in violation of Section 7 of the Clayton Act (38 Stats. 731, as amended, 64 Stat. 1125, 15 U.S.C. Section 18).

Thereafter proceedings commenced in the District Court of Utah where the trial judge dismissed the antitrust suit but in *United States v. El Paso Natural Gas Company* (376 U. S. 651) in 1964 this court found that the acquisition of the stock and assets of Pacific by El Paso was a violation of Section 7 of the Clayton Act and remanded the case to the District Court with these instructions:

"Since appellees have been on notice of the antitrust charge from almost the beginning—indeed before El Paso sought Commission approval of the merger—we not only reverse the judgment below but direct the District Court to order divestiture without delay." (Pg. 662)

The Divestiture Proceedings in the District Court

It was on April 6, 1964, that the Supreme Court rendered its mandate and as previously stated directed the "District Court to order divestiture without delay." Subsequently on July 8, 1964, the first hearing was held before the lower court but because of the complexities of the task at hand various continuances were granted. On October 13, 1964, El Paso filed with the lower court that document entitled "El Paso Natural Gas Company's Proposal for Divestiture" (R. 1835). It should be pointed out that the continuances which occurred from time to time were for the purpose of permitting the government to analyze the El Paso proposal for divestiture while at the same time negotiations occurred intermittently between El Paso and the government seeking a satisfactory divestiture plan.

The Proposal of El Paso

El Paso's proposal for divestiture was confronted at the outset by immediate government opposition. On October 19, 1964, hearings resumed at which time El Paso offered in evidence its Proposal for Divestiture and at the same time presented comment and testimony with respect to the terms of its proposal (R. 1875, 131, 140, 142.) At that time, the government, needing time to evaluate the newly presented divestiture proposal and requiring additional information, was granted additional time by the court for analysis of El Paso's proposal.

It was on December 2, 1964, that hearings resumed at which time the El Paso plan for divestiture was the subject of examination by the government which was quite plain in its complete opposition to such plan.

The original El Paso proposal proposed a spin-off of the assets of Pacific Northwest to a new company and a distribution of the capital shares of new company to the shareholders of El Paso (R. 1835). This original proposal was simply a transfer of the ownership of Pacific Northwest or new company to the individual shareholders of El Paso. Such a program was hardly calculated to create an independent pipeline corporation.

Additionally, the divestiture plan failed to make any provision for an equitable apportionment of gas reserves acquired in the San Juan Basin during the time of illegal ownership and control by El Paso of Pacific; the divestiture plan ignored completely the fact that one of the valuable assets of Pacific Northwest was the stock ownership in West Coast Transmission Company, Ltd.; the divestiture plan failed to compensate Pacific Northwest for certain tax loss carry overs which were available to Pacific Northwest at the time of the stock acquisition and merger (R. 1835).

The record below was made without participation by intervenors. It was fashioned by El Paso and the government but no testing by third parties was permitted. Nor was any evidence which might have been brought forward by third parties thereby possible. It is reasonable to conclude that the proposals made by El Paso and the Decree for Divestiture subsequently conceded to by the government could and should have been the subject of very productive examination by parties affected thereby. As it stands, however, California and the other appellants are before this court on the record made in which they had no voice whatsoever.

The Opposition of the Government

On January 6, 1965, the government presented its brief opposing El Paso's plan for divestiture and significantly presented an alternative plan (R. 1049 to 1076). The succinct criticism of El Paso's proposal is found in these words by the government in opposition:

> "First: El Paso's 'spin-off' plan fails to establish New Company as a corporation that will be completely independent of El Paso. Under the El Paso Plan of Divestiture a community of interest may be maintained between the two companies through their ownership by substantially the same stockholders. Even if El Paso refrains from overt interference in the affairs of New Company it is unreasonable to expect New Company's management—however well intentioned—to actively compete with El Paso for new markets and new gas supplies while subject to common ownership.
>
> "Second: The failure to allocate to New Company a fair share of the important San Juan Basin gas reserves that have been acquired by El Paso since the stock acquisition and since the merger, will deprive New Company of its fair share of gas which it would need to compete for additional markets.
>
> "It should be recalled that the Supreme Court found that
>
> > 'Pacific Northwest was no feeble, failing company; nor was it inexperienced and lacking in resourcefulness. It was one of the two major interstate pipelines serving the trans-Rocky Mountain States; It had raised $250 million for its pipeline that extended 2,500 miles through rugged terrain. It had *adequate reserves* and managerial skill. It was so strong and militant that it was viewed with concern and coveted, by El Paso.' 376 U. S. 651 at 661-62.
>
> "Failure to provide for an appropriate allocation of these combined gas reserves would make it a more

feeble competitor than Pacific Northwest would have been had it remained independent of El Paso.

"Third: Under the El Paso plan certain contracts to which Pacific Northwest had been a party, prior to the merger, will be transferred to New Company with this important difference: El Paso has unilaterally changed some of the most important provisions in these contracts to the detriment of New Company. We think then any such changes should not be forced on New Company through El Paso's unilateral action but should be arrived at through arms length bargaining subject to the normal review procedures of the Federal Power Commission.

"Fourth: El Paso proposes to hold back from New Company one of the most valuable assets it acquired from Pacific Northwest, i.e., 1,157,125 shares of common stock in Westcoast Transmission Company, Ltd. valued at approximately $17 million. It is our position that implicit in any divestiture order is a requirement that El Paso must return what it acquired.

"Fifth: El Paso, in its plan, has made no effort to allocate to New Company another principal asset acquired from Pacific Northwest at the time of the merger consisting of over $53 million in tax loss carryovers. Clearly some fair allocations must be made of this asset and we shall speak of this in more detail in a later portion of this brief." (R. 1052-1053.)

After its opposition to El Paso's proposal for divestiture, the government then set forth in the brief referred to its own proposal. The principal terms of that proposal were as follows:

"1. El Paso is ordered to divest itself of the assets described in its Plan of Divestiture and, in addition, of (a) a fair share of gas reserves acquired in the San Juan Basin since January 1, 1957, the date of the stock acquisition; (b) the 1,157,125 shares of common stock in

Westcoast Transmission Company, Ltd. which were acquired as part of the merger; and (c) a fair share of the value of the tax losses of Pacific Northwest received by El Paso as a result of the merger.

"2. All contracts between El Paso and Pacific Northwest existing at the date of the merger, December 30, 1959, are to be reinstated, subject to such modifications as the Federal Power Commission may make in the exercise of its jurisdiction.

"3. Such assets are to be divested at a date and to a purchaser to be determined by further order of the Court.

"4. The Court will schedule hearings on proposals by persons interested in purchasing the assets and operating the facilities to be divested.

"The Court may then reach an informed judgment as to whether a satisfactory third party purchaser is now available or whether a 'spin-off' that would promptly eliminate common ownership and control of the New Company by El Paso must be employed to accomplish the requisite divestiture." (R. 1075-1076.)

The Existence of Third Party Purchasers

California recognizes and with a degree of frustration that the longer the mandate of the Supreme Court is ignored so much more difficult becomes the task of divestiture. But despite the additional burdens time has imposed, the record herein is quite clear that there are third parties who are adjudged competent, qualified and financially able to make an outright purchase of the new company. None of these prospective purchasers is associated with El Paso but El Paso declines to negotiate with any of them. The government in its brief stated:

"Thus sale to a third party is both a desirable and feasible alternative to the El Paso plan."

Reference is made to the letter offer from Paradox Production Corporation addressed to El Paso in which Paradox offers

> ". . . to purchase the assets which will be the subject of the divestiture order at such price and on such terms and conditions as may . . . appear fair, equitable and proper." (R. 25)

It is clear that Paradox Production Corporation is anxious to make an outright purchase of the assets of the new corporation to supply it with independent management and ultimately with an equitable divestiture of gas reserves and sound capital structure to compete for the California gas market (R. 107, 117, 121, 122).

Pacific Western Pipeline Corporation was formed with the stated objective of negotiating with El Paso for the acquisition of the properties which were to be divested. Its further objective was that "of managing, operating, maintaining and expanding those properties as a strong independent and viable pipeline system . . ." (R. 1213). Both Paradox and Pacific Western were characterized by the government as "able and willing buyers each of whom is competent to operate the pipeline company divested. Further El Paso has stipulated on the record that these persons are financially responsible and are able to manage the pipeline."

Reference is made to testimony of Roger L. Conkling (R. 1218 et seq.) on behalf of Pacific Western Pipeline Corporation testifying to the independence of Pacific Western Pipeline Corporation; its objective of acquiring the properties of Pacific Northwest; its capabilities of operating a pipeline and its desire to compete for the California market. This is true as well as to Paradox Production

Corporation which also stated unequivocably its desire to enter the California market (R. 1212).

It should be pointed out that while two corporate entities are before the court as a matter of record willing to make an outright purchase of the new company, there undoubtedly would be others if opportunity were given on an equal and open basis for all to make an outright purchase.

It is interesting to note that the government presented to the lower court (R. 1584) a Proposed Decree which significantly stated that the assets El Paso proposed to transfer to the new company were not sufficient to make it a competitive pipeline; that El Paso should transfer to New Company the shares of stock in West Coast Transmission Company, Ltd; that a more equitable share of gas reserves in the San Juan Basin should be made; that recognition be given to the value of the tax loss carry over; and that all contracts existing between El Paso and Pacific Northwest should remain in effect as originally executed subject to modification only by the Federal Power Commission.

This offered Decree further requested the court

> ". . . to hear and consider whatever specific proposals any third parties may wish to make for the outright purchase of all of the assets formerly owned by Pacific Northwest and such related assets subsequently acquired by El Paso as Pacific Northwest might reasonably have acquired absent its acquisition by El Paso before approving any specific divestiture proposal." (R. 1586)

It seems a common sense proposition and the proposed decree referred to recognizes the fact that divestiture is best accomplished by outright sale to third parties, absent the complexities and delaying tactics which are inherent in the El Paso proposal and in the decree for divestiture as ultimately signed.

V.

SUMMARY OF ARGUMENT

This protracted litigation has thus far permitted a violation of Section 7 of the Clayton Act without end. This merger as originally approved by the Federal Power Commission was set aside in *California v. Federal Power Commission*, supra, and subsequently in *United States v. El Paso Natural Gas Company*, supra. This combination of pipelines was declared in violation of Section 7 of the Clayton Act. The critical ever retreating point which must be reached is that the mandate of this court be respected, whether California seeks to do so as an intervenor to protect valuable rights or whether this court has noted probable jurisdiction because it inclines toward the view that its mandate is not being respected.

Very simply when it is recalled that this court ordered "divestiture without delay" a mere knowledge of the time inherent in this litigation discloses that the mandate is being ignored.

The mandate is ignored not only with reference to time but the manner in which Pacific Northwest was to be set up as a new independent corporation deprives it of resources, capital and independence of management which is essential so that it may compete for the California gas market as the Supreme Court found it clearly able to do. And California maintains that where as here its interests are not being represented adequately by the government that a case for intervention had been made out and further where as here the mandate of the court is being ignored that this court regardless of the position of California may take this case unto itself for review simply because California has addressed its plea to the court on that basis as well.

The Mandate of the Court and Its Power to Compel Compliance with Such Mandate

Even if the decree for divestiture were more satisfactory in terms of creating a competitive pipeline, the decree still must be faulted for the delay mechanism built into it. The court should view its mandate as to time in light of the fact that as long ago as 1955 El Paso commenced negotiations for the acquisition of Pacific. On November 8, 1956, the shareholders of Pacific and El Paso agreed upon the terms of the stock exchange offer. As long ago as July 22, 1957, the stock acquisition was the subject of a complaint by the Attorney General of the United States. And then in *California v. Federal Power Commission* (1962) the asset approval of the Federal Power Commission was struck down by the Supreme Court. Then in *United States v. El Paso Natural Gas Company* the court declared this merger to be in violation of Section 7 of the Clayton Act and directed that it be set aside at once. So now we are a decade from the date the stock acquisition first became a reality; an acquisition in violation of Section 7 of the Clayton Act. That violation has never ceased from that day to this and under the El Paso decree for divestiture is running even now.

It is beyond argument that this court ordered divestiture to occur as promptly as possible, particularly as it said "Since appellees have been on notice of the antitrust charge from almost the beginning." And when this is measured against the perplexing time consuming divestiture plan ultimately agreed upon, then the reality of an outright sale to others is clearly one way of meeting the mandate. (See pages 18 and 19 of California's Jurisdictional Statement.)

The Decree for Divestiture Falls Short of Creating a Competitive Pipeline

The Decree for Divestiture was signed by the lower court on June 24, 1965. (R. 2172)

The Decree by its terms allocates less by the way of gas reserves to new company than Pacific Northwest had when it was independent. And of course competition for the California market will require new company to have adequate reserves. The allocation of gas reserves to new company ignores the fact that following the illegal merger large quantities of new gas were developed in the San Juan Basin (R. 1720, El Paso Natural Gas Company 1962 Annual Report, page 17).

In short the new company is being deprived of those natural gas reserves which would have come to it by its exploration and development activities had it remained independent.

The decree for divestiture is harmful to new company in that El Paso after the merger unilaterally changed the Kingsgate gas contract to impose onerous provisions upon new company requiring it to take high priced Canadian gas neither desired nor needed by new company and serving only to burden it.

The decree is deficient and imposes burdens upon new company in the San Juan gas gathering agreement in that El Paso unilaterally increases the gathering charge in the San Juan Basin from 1.35¢ per 1,000 cubic feet for gas there gathered to 4.5¢ per 1,000 cubic feet. This will impose an additional annual increase in expense and cost to new company of over $644,000 for the fifth year of operation.

California is saying here that these one sided contract changes should be made if at all only by an independent new company negotiating from strength with El Paso and then subject to approval or disapproval by Federal Power

Commission. It is not in keeping with the mandate of this court nor with the objectives which this court has previously pronounced for new company to permit El Paso by its continued illegal control of new company to impose burdensome financial obligations upon new company which detract from its ability as a competitor.

As to the question of gas reserves, the unilateral changes made by El Paso in contracts negotiated with Pacific Northwest; the Kingsgate gas contract; the San Juan agreement and the tax loss carry-over—these things are discussed at length in the brief by the appellant Southern California Edison and will not be gone into here.

Westcoast Transmission Stock

As an independent pipeline corporation, Pacific Northwest owned approximately 25% of the common stock of the Westcoast Transmission, Ltd. This was a supplier of natural gas to Pacific Northwest and because of the stock ownership gave Pacific Northwest not only a valuable asset but a favorable bargaining position in terms of acquiring gas. The government and California opposed the El Paso divestiture plan under which El Paso kept unto itself all of the Westcoast Transmission stock which was unlawfully acquired. As the government recited in its brief (R. 1070):

> "In 1956 Pacific Northwest acquired 25 percent of the common stock of Westcoast Transmission, Ltd., a Canadian pipeline company which supplied gas to Pacific Northwest at the U.S. Canadian border. Pacific Northwest's cost for these 1,125,750 shares equalled $5,638,750. As a result of [fol. 498] the merger these shares were acquired by El Paso from Pacific Northwest.
>
> "El Paso does not propose to transfer these shares to New Company. Instead it proposes to sell its stock

interest in Westcoast and retain the proceeds for itself. These shares are presently valued at between $17-20 million.

"There is no justification for El Paso selling this stock at a substantial profit to itself. This stock is an asset which belonged to Pacific Northwest and it is our firm opinion that it should be transferred along with the other acquired assets. Certainly the mandate of the Supreme Court that the acquired assets be divested cannot be interpreted as calling for a piecemeal sale of those assets to the highest bidder. All of the acquired assets, including the Westcoast stock should be divested intact to a single purchaser. Although we believe that the purchaser should be required to dispose of the Westcoast stock because Pacific Northwest probably acquired it illegally, its disposition should not be determined by El Paso, but by the Court. Certainly, the proceeds of the sale should be New Company's, not El Paso's. If the stock were sold by New Company it would provide a substantial sum for working capital purposes which now must be borrowed."

The merger transaction is illegal by pronouncement of this Court. It follows then that El Paso is to divest itself of all of the proceeds of the merger obtained illegally, one of which was the acquisition of the Westcoast Transmission stock. The law requires that this asset and its increase in value be returned to new company as a valuable and necessary asset to restoring new company as a competitive viable pipeline. Unless El Paso divests itself of such stock it will have benefited by its own wrong, here, by selling an asset illegally obtained and realizing a handsome profit on the rise of equity value of Westcoast Transmission holdings.

The Decree for Divestiture Fails as to Time and as to Outright Separation of the Merged Companies

Reference is made to the Decree for Divestiture (R. 2172). This plan as already noted permits El Paso to retain valuable assets which it acquired illegally and which should be returned to new company. This plan creates a chief executive officer and then permits or directs—it is not clear —a stock exchange within 18 months after the transfer of assets to new company or if the stock exchange be not successful then El Paso is directed to sell all shares of stock in new company within 18 months. The vice in this Decree is that these things are to be done "within 3 years." This is an unduly long period of time—hardly in keeping with the concept of divestiture without delay. This then permits the reality that El Paso will continue to dominate the new company. During the 3 year period given El Paso to divest itself of new company stock (R. 2020) El Paso continues to assert control over new company. It may be that the provision of the Decree permitting El Paso shareholders to exchange El Paso equity for new company equity may not be utilized. If such be the case then El Paso has an additional 18 months to make a public offering of stock of new company.

The Decree for Divestiture perpetuates rather than terminates the unlawful merger. The extraordinary time which has elapsed from the birth of this illegal transaction has created problems in terms of giving complete and adequate relief and recognition to the restraints of the Clayton Act. It should be borne in mind however that the difficulties which now confront California and the other appellants were the fruits of an illegal merger and were the making of El Paso when it violated Section 7 of the Clayton Act. California recognizes that there is difficulty in unscrambling this tainted transaction. But nonetheless we come down to a hard choice between the enforcement of the Clay-

ton Act, the enforcement of the court's mandate or the convenience of El Paso. It is the interest of the public which is paramount here and if undesirable consequences are to be visited upon El Paso this is a decision El Paso made many years ago.

California is of the view that the Decree which the government offered in the proceedings below (R. 1584) should be adopted by this court. Particularly is California insistent that there be an immediate and outright separation of the ownership of Pacific and El Paso. This court has the power so to do and we urge that it be done. There should be a limitation as to time placed upon the doing of these things from the time the court hands down its decision. And it should be made quite plain that only persons completely independent of El Paso should be eligible as members of the public entitled to purchase stock in the new company. California is of the view that absent such a directive of this court that the Clayton Act will be frustrated and the unlawful merger perpetuated.

Today the successor to Pacific Northwest is a creature of El Paso. Its management was selected by El Paso and under the Decree for Divestiture will be subject to the complete control of El Paso. The new corporation will have no assets until such time as a Certificate of Public Convenience and Necessity issues from the Federal Power Commission. It must be obvious that this type of corporation is neither intended to nor capable of rendering competition for the California gas market particularly in view of all the disabilities heaped upon it by El Paso (R. 2172).

This court has the power to vacate the Decree for Divestiture and to direct that there be a complete separation of the equity control by El Paso of the new pipeline corporation. At the same time this court has the power to compel

El Paso to divest itself of assets previously belonging to Pacific Northwest Pipeline Corporation and to give them over to the successor thereto so as to permit it to be a competitive line for the California market. *United States v. Dupont and Company*, 366 U.S. 316 at 334.

CONCLUSION

California is not unmindful of the difficulties which time has created in this litigation but it is important to bear in mind that the delaying tactics commencing with the deliberate violation of Section 7 of the Clayton Act and the subsequent scrambling of assets were El Paso's doing. There is a hard choice to be made here but if the prior decisions of this court pertaining to this unlawful monopoly are to have any meaning then the relief which California and the other parties seek should be granted.

The original government proposal herein requesting the lower court to entertain specific proposals for the outright purchase by third parties should be utilized. This court itself should fashion a decree with fixed terms and conditions and direct the lower court or an appointed master to see that such conditions are carried out.

WILLIAM M. BENNETT
Room 5052, State Building
San Francisco, California

Special Counsel for the People of the State of California